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CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.3: ADVANCED FINANCIAL REPORTING

DATE: TUESDAY 27, MAY 2025

MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE:

Marking guide

Q/NO	CRITERIA OF AWARDING MARKS	MARKS
Q1a	Clear explanation of business under IFRS 3 (inputs, processes, outputs) Application to Kamonyi Ltd (inputs & processes analysis) Optional test and outcome Comparison of business combination vs asset acquisition Final judgment supported by analysis	1.5 2.5 1 2 1 **8**
Q1b(i)	Amount of disposal proceeds from the sale of shares award 0.5mark For reserves (ordinary shares) award 0.5mark For reserves (share premium) award 0.5mark For reserves (revenue reserves) award 0.5mark For the group share of net assets on disposal award 0.5mark For unimpaired goodwill disposed award 0.5mark For the proportion of net assets disposed award 0.5mark For the gain on disposal award 0.5mark	0.5 0.5 0.5 0.5 0.5 0.5 0.5 0.5 **4**
Q1b(ii)	Correctly computed goodwill amount on acquisition of S ltd award 2m Correctly computed goodwill amount on acquisition of R ltd award 2m	2 2 **4**
Q1b(iii)	Correctly/accurately computed consolidated turnover award 1 mark Correctly computed consolidated cost of sales award 2marks Correct amount of consolidated gross profit award 0.5mark Well computed group share of profit from associate award 1mark Correct computed amount of selling and distribution expense award 1 Correct consolidated amount of administration expense award 1mark Correctly computed amount of consolidated finance cost award 1 mark Correct amount of profit before tax consolidated award 0.5mark Correctly computed income tax expense consolidated award 1mark Correct amount of profit after tax award 0.5mark Correctly computed amount of NCI share of profit after tax award 2.5 Correct amount of profit after tax attributable to the group award 1mark	1 2 0.5 1 1 1 1 0.5 1 0.5 2.5 1 **13**
Q1b(iv)	Correctly computed PPE figure award 2marks Correctly computed investment in associate award 2marks Other investments figure correctly consolidated award 0.5mark Correct amount of goodwill award 0.5mark Correct amount of inventory award 0.5mark	2 2 0.5 0.5 0.5

	Correct amount of trade and other receivables award 0.5mark Correct amount of prepayments award 0.5mark Correct amount of short-term investments award 0.5mark Correct amount of cash and bank balance award 1mark Correct amount of trade and other payables 0.5mark Correct amount of accruals award 0.5mark Correct amount of ordinary share capital award 0.5mark Correct amount of share premium award 0.5mark Correct amount of revenue reserve award 2marks Correct amount of other reserves award 0.5mark Correct amount of NCI award 1mark Correct amount of bank loan award 0.5mark Correct amount of loans tock award 0.5mark Correct amount of deferred tax award 0.5mark	0.5 0.5 0.5 1 0.5 0.5 0.5 0.5 2 0.5 1 0.5 0.5 0.5 **15**
Q1b(ii)	For correct item stated award 1 mark, explanation award 1mark	6 **6**
Q1	**Total marks awarded (4+6+15+15+4+6)**	**50**

MODEL ANSWER
Question One A)

IFRS 3 defines a business as: An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income, or generating other income from ordinary activities.

To qualify as a business, the acquired set must include at least:

- Inputs, and
- Processes that together have the ability to create outputs.

Importantly, outputs are not strictly required at the acquisition date. The ability to produce outputs in the future is sufficient.

At acquisition:

- **Inputs present**: Kamonyi Ltd held assets such as R&D equipment and laboratory facilities.
- **Processes**: Limited; only junior researchers were employed, and Kamonyi Ltd lacked the technical expertise required to turn R&D into a viable product.
- The company did not have a developed operational plan or proprietary production processes in place.

Thus, while some inputs exist, substantive processes may be absent. The lack of experienced human capital and operating capability suggests Kamonyi Ltd may not meet the business definition.

IFRS 3 provides an optional **“concentration test”**:

If substantially all the fair value of the gross assets is concentrated in a single identifiable asset or group of similar assets, the set is not a business. In this case, if Kamonyi Ltd’s assets are primarily laboratory equipment and property of similar fair value, the test may indicate that Kamonyi Ltd is just a collection of assets. Therefore, the acquisition could be classified as an asset acquisition.

If Kamonyi Ltd is NOT a business, the acquisition should be treated as an asset acquisition, not a business combination. This has key implications:

- No goodwill is recognized.
- Transaction costs are capitalized, not expensed.
- Each identifiable asset and liability is recognized individually at cost (allocated based on relative fair values).
- There is no recognition of deferred tax arising from initial recognition differences.

On the other hand, if it were a business:

- Muhanga Ltd would apply IFRS 3 acquisition accounting,
- Recognize goodwill or gain on bargain purchase,
- Expense acquisition-related costs, and
- Recognize fair value adjustments and possible deferred taxes.

Given Kamonyi Ltd lacks the necessary substantive processes and operational capabilities, and assuming the concentration test is met, it is most likely that Kamonyi Ltd does not qualify as a business under IFRS 3. Therefore, Muhanga Ltd should account for the acquisition as an asset acquisition, not a business combination.

Question One B

(i) Gain/loss on disposal of H Ltd shares in R Ltd.

Details	**FRW “000”**
NCI at acquisition {(480,000+45,000) + (62,600*9/12)}*25%	142,988
NCI share of post acquisition profit to disposal {(62,600*3/12) + (72,400*9/12)}*25%	17,488
NCI at disposal date	**160,475**
Increase in NCI at the disposal date (160475*15%/25%)	96,285
Total NCI after disposal	**256,760**

NCI share of post-acquisition after disposal (72,400*3/12)*40%	7,240
NCI at Reporting Date	**264,000**

Details	**FRW "000"**
Fair value of consideration received	80,000
Increase in NCI at the disposal date	(96,285)
Profit/Loss on disposal of shares	**(16,285)**

(ii) Compute goodwill on the acquisition of S Ltd, R Ltd and A Ltd.

Details	**S ltd (80%)**	**R ltd (75%)**
Purchase consideration	**FRW**	**FRW**
Cost of investment	403,600,000	470,310,000
Share exchange	42,000,000	-
Total purchase cost	**445,600,000**	**470,310,000**
Net assets acquired		
Ordinary share capital	320,000,000	360,000,000
Share premium	32,000,000	33,750,000
Pre-acquired revenue reserves	41,600,000	35,212,500
Total net assets acquired	**393,600,000**	**428,962,500**
Goodwill on acquisition	52,000,000	41,347,500
Impairment loss during the year	-	-
Goodwill carrying value to CSFP	**52,000,000**	**41,347,500**

Total Goodwill = 52,000,000 + 41,347,500 = 93,347,500

W1: Determination of percentage of control

S Ltd $\frac{320,000 \times 100\%}{400,000} = 80\%$

R Ltd $\frac{360,000 \times 100\%}{480,000} = 75\%$

A Ltd $\frac{108,000 \times 100\%}{360,000} = 30\%$

W2: Other incomes consolidated

Details	**FRW"000"**
Other incomes	50,000,000
Dividends (intra-group)	
S Ltd =80% (30,000 - from the P&L figures)	(24,000,000)
R Ltd =75% (20,000 - from the P&L figures)	(15,000,000)
A Ltd = 30% (20,000 – from the P&L figures)	(6000,000)
Interest income (Intra-group)	

S ltd: 10% loan stock (10% x FRW 100m x 50% loan notes purchased by H Ltd)	(5,000,000)
	0

W3: Intercompany sale of PPE
With profit on sale of FRW 50,000,000
Dr income statement A/C (H ltd)
Cr PPE A/C (S ltd)

Depreciation of gain on sale (overcharge)
20% (50,000,000) = 10,000,000

Dr S Ltd PPE A/C
Cr S Ltd income statement A/C

W4. Intercompany sales
With the intercompany sales of FRW 100,000,000
Dr H ltd sales A/C
Cr S ltd cost of sales

Unrealized profit on closing stock (UPCS)
Closing stock ½ (100,000,000) = 50,000,000
Profit mark-up is 25%
Profit margin 25/125 (50,000,000) = 10,000,000
With unrealized profit on closing stock of FRW 10,000,000 on the inventory of H ltd
Dr H Ltd Income Statement a/c
Cr S Ltd inventory a/c

W5. Intercompany debts
H Ltd owed S Ltd FRW 80,000,000

Dr cash in transit	10,000,000	
Dr Group trade payables	70,000,000	
Cr Group trade receivables		80,000,000

W6. NCI share of profit after tax
NCI share in S Ltd (20%)

Profit after tax during the year	98,000,000
Depreciation overcharge	10,000,000
Unrealized profit on closing stock	(10,000,000)
Adjusted profit after tax	98,000,000

NCI share 20% (98,000,000) = FRW 19,600,000

NCI share in R Ltd (phase one & two)

Profit after tax during the year	92,400,000

First 9 months before disposal of shares

9/12 × 25% (92,400,000) =	FRW 17,325,000

After disposal of shares

Number of shares disposed 72,000

New percentage of control = $\frac{(360,000-72,000) \times 100\%}{480,000} = 60\%$

NCI share is 100% - 60% = 40%

3 months after disposal of 72,000 shares

3/12 × 40% (92,400,000) =	FRW 9,240,000
	26,565,000
Total value of profit after tax attributable to NCI	**FRW 46,165,000**

W7. Sales revenue consolidated

H LTD	800,000,000
S LTD	700,000,000
Inter-company sales	(100,000,000)
R LTD	600,000,000
	2,000,000,000

W8. Cost of sales consolidated

H LTD	250,000,000
Intercompany sales	(100,000,000)
S LTD	250,000,000
R LTD	200,000,000
Add UPCS	10,000,000
Less depreciation overcharge	(10,000,000)
Add unrealized profit (PPE)	50,000,000
	650,000,000

(iii) H and its investee companies consolidated income statement for the year ended 30th September 2023.

H & ITS INVESTEE COMPANIES
CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 30TH SEPTEMBER 2023
END OF MARKING GUIDE AND MODEL ANSWERS

Details/particulars	**FRW "000"**	**FRW "000"**
Turnover		2,000,000
Cost of sales		(650,000)
Gross profit		**1,350,000**
Add other incomes		
Profit after tax from the associate		23,772
Total incomes		1,373,772
Operating expenses		
Selling and distribution expenses	635,000	
Administration expenses	355,000	(990,000)
Operating profit		383,772
Finance cost		(33,000)
Profit before tax		**350,772**
Income tax expense		(126,600)
Profit after tax		224,172
NCI share of profit after tax		46,165
Profit attributable to the group		178,007
		224,172

W9. Assets Working

Details	**PPE**	**Other Investment**	**Inventory**	**A/R**	**Prepayment**	**Invest**	**Bank**
FRW	**"000"**	**"000"**	**"000"**	**"000"**	**"000"**	**"000"**	**"000"**
HLTD	479,000	50,000	100,000	140,000	10,000	50,000	101,000
SLTD	404,000	20,000	150,000	120,000	8,000	22,000	101,000
RLTD	609,000	10,000	100,000	80,000	5,000	15,000	71,000
PPE sales gain	(50,000)						
Depreciation	10,000						
UPCS			(10,000)				
Cash in transit							10,000

Loan stock in S							(50,000)
Inter-co debts				(80,000)			
Sale of shares							80,000
	1,452,000	**80,000**	**340,000**	**260,000**	**23,000**	**87,000**	**313,000**

W10. Equity And Liabilities Working

Details	**OSC**	**S/PRE**	**R/RES**	**B/LOAN**	**10%L/S**	**D/TAX**	**A/P**	**ACCR**
FRW	**"000"**	**"000"**	**"000"**	**"000"**	**"000"**	**"000"**	**"000"**	**"000"**
HLTD	800,000	80,000	250,000	6,000	500,000	4,000	190,000	109,138
SLTD				3,000	100,000	2,000	150,000	10,000
RLTD				3,000	80,000	2,000	135,000	10,000
New issue	40,000	2,000	-	-	-	-	-	-
PPE gain	-	-	(50,000)	-	-	-	-	-
Dep adj on the unrealized profit on PPE 80%*10,000	-	-	8,000					
Uunrealized profit on PPE	-	-	(10,000)					
Intercompany debt			-				(70,000)	
Post acquisition share of profits in S (WK13)			54,400					
Post acquisition share of profits in R (WK 14)			63,323					
Post acquisition share of profit in profits A (WK 15)			17,772					
Gain on sale			(16,285)					
Intercompany loan					(50,000)			
	840,000	**82,000**	**317,210**	**12,000**	**630,000**	**8,000**	**405,000**	**129,138**

W11. NCI Balance to The Statement of Financial Position

NCI in S Ltd (20%)

NCI at acquisition (400,000+40,000+52,000) *20%		98,400
Post acquisition share of Profit		
Profit after tax during the year	68,000	
Depreciation overcharge	10,000	
Post acquisition share of Profit		15,600
NCI at the reporting period		**114,000**

NCI in R Ltd at reporting Date (see (i) above	**264,000**
Total NCI at reporting Date (114,000 + 264,000)	**378,000**

W 12. Investment In Associate

Details	**FRW"000"**
Investment in associates at the start of the year	135,228
share of post-acquisition profit (105,000-45,760)	23,772
	159,000
Dividend received	(6,000)
Closing investment in Associate	**153,000**

WK 13 Post acquisition share of profits in S

Details	**FRW"000"**
Retained earnings as per the balance sheet date	120,000
retained earnings at the start of the year	(52,000)
Adjustments	
Depreciation overcharge on gain of PPE 20%*50,000	10,000
Unrealized profit on inter-company trading	**(10,000)**
Adjusted post acquired profit	**68,000**
Parent share of the profit 80%*68,000	**54,400**

WK 14 Post acquisition share of profits in R

Details	**FRW"000"**
3 months post acquired profit 62,600*3/12	15,650
9 months post acquired profit 72,400*9/12	54,300
TOTAL PROFIT	**69,750**
Share of post acquired profit 75%*69,750	52,463
Share of the profit for 3 months	
72,400*60%*3/12	**10,860**
Total profit share 52,463+10,860	**63,323**

WK 15 Share of profit in associate

Details	FRW"000"
Share of the profit after tax 30%*79,240	23,772
Less the share of the dividend received from the associate	(6,000)
Profit share after dividend	**17,772**

(iv) H and its investee companies' consolidated statement of financial position as at 30th September 2023.

H AND ITS INVESTEE COMPANIES
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 30TH SEPTEMBER 2023

Non–Current Assets	**FRW "000"**	**FRW "000"**
PPE (W9)		1,452,000
Investment in associate (W12)		153,000
Other investments (W9)		80,000
Goodwill (ii)		93,348
Total non-current assets		**1,778,348**
Current Assets		
Inventory (W9)	340,000	
Trade and other receivables (W9)	260,000	
Prepayment (W9)	23,000	
Short-term investment (W9)	87,000	
Cash and bank balances (W9)	313,000	
Total current assets		**1,023,000**
Total Assets		**2,801,348**
Equity and Liabilities		
Equity & Reserves		
Issue and paid-up capital (W10)		840,000
Share premium (W10)		82,000
Retained Earnings (W10)		317,210
NCI shareholding (W11)		378,000
Total equity		**1,617,210**
Long-Term Liabilities		
Bank loan (W10)	12,000	
10% loan stock (W10)	630,000	
Deferred tax liability (W10)	8,000	
Total long-term liabilities		**650,000**
Current liabilities		
Trade and other payables (W10)	405,000	
Accruals (W10)	129,138	
Total current liabilities		**534,138**
TOTAL EQUITY & LIABILITIES		**2,801,348**

(v) Explain three items that are not consolidated even though they appear in the financial statements of either the parent or the subsidiary.

a). **Dividend income** –
If the parent or any other member of the group invested in another group and received dividends from such an investment, this is in intragroup item which never consolidated when preparing financial statements

b) **Interest/investment income** -
sometimes the parent can acquire a loan stock in an investee company and receive interest from such an invest, this is an intragroup item which is never consolidated when preparing financial statements.

c) **Gain on sale of shares in the subsidiary**
If the parent company decides to sell part or entire investment in acquired in the subsidiary, the gain reported on disposal is not the one consolidated. A computation has to be done for the gain on disposal reported in the consolidated statements.

d) **Intercompany sales**
This is an intragroup item which must not be consolidated, it must be deducted from the sales of the selling company and from the cost of sales of the purchasing company
e) **Unrealized profit on closing stock**
when either company sells goods to other company within the group and part of this goods remain in the inventory of the purchasing company, the profit that was charged must be calculated and deducted from the closing stock.
f) **Intercompany indebtedness**
Because of intercompany trading on credit terms, at the end of the year companies within the group owe each other some amount, this cannot be consolidated, instead it has to be eliminated on consolidation.

SECTION B

QUESTION TWO

Marking guide	Marks
a) IFRS 1 - First-time adoption to International Financial Reporting Standards	
Award as below:	
(i) Appropriate definitions of an "opening statement of financial position" (1 mark) and "the date of transition to IFRS financial statements" (1 mark). This must be in conformity to IFRS 1 and must apply to Maxima Ltd. A maximum of 2 marks	2
(ii) Award 1 mark for each correct reference to an acceptable previous accounting framework through which Maxima's financial statements can be prepared in order to transit to IFRS Accounting Standards. A maximum of 3 marks	3
Total marks for Q2 (a)	**5**
b) Statement of cash flows for Maxima Ltd	
Award 0.5 marks for each correct figure (including sub-totals and totals) used in the presentation of the statement of cash flows (including where these figures may have been used through workings). Maximum marks is 20 marks	20
Total Marks for Question Two	**25**

Model Answer

Part (a): First-time adoption of International Financial Reporting Standards based on Maxima Ltd as a first-time adopter of IFRS standards

In relation to the Board's approval for Maxima Ltd to adopt the publication of the first-time IFRS financial statements for the year ended 31 December 2024:

i) Meaning of Opening IFRS statement of financial position: this is the statement of financial position of a company at the date of transition to IFRS where the **date of transition** is the beginning of the earliest period for which an entity presents full comparative information under IFRS Accounting Standards in its first IFRS financial statements.
In the case of Maxima Ltd, the date of transition to IFRS is 1 January 2023 which is practically the beginning of the earliest period for which Maxima Ltd is able to present full comparative information under IFRS Accounting Standards in its first IFRS financial statements for the year ended 31 December 2024.

ii) Maxima Ltd will apply IFRS 1 only when the company's previous financial statements were presented under the following accounting framework – i.e., where the financial statements were prepared:

- ✓ in accordance with national GAAP that is not fully consistent with IFRS Accounting Standards; or
- ✓ in full conformity with IFRS Accounting Standards except that the financial statements did not include an explicit statement of compliance; or
- ✓ in conformity with some but not all IFRS Accounting Standards, with a corresponding statement of compliance; or
- ✓ in accordance with national GAAP that is inconsistent with IFRS Accounting Standards but using IFRS Accounting Standards as a fallback where no national standard exists; or
- ✓ in accordance with national GAAP with a reconciliation to amounts under IFRS Accounting Standards.

Part (b): Maxima Ltd statement of cash flows for the year ended 31 December 2024

	FRW million
Cash Flows generated from Operating activities	
Profit before tax	4,778
Adjustments for:	
Finance cost	2,950
Loss on disposal of PPE	27
Dividend Income	(1,260)
Revaluation loss on PPE	1,240
Depreciation charge for PPE in the year	4,280
Amortisation charge for Intangible in the year (3,700 - 3,520)	180
Current service cost - defined benefit pension scheme	725
Operating cash flows before changes in working capital	**12,920**
Increase in inventory (5,165 - 4,900)	(265)
Decrease in trade receivables (9,754 - 8,641)	1,113
Increase in trade payables (964 - 522)	442
Cash generated from Operations	**14,210**
Finance cost paid (2,950 in P&L + 354 payable balance on 1 Jan 2024 - 150 payable balance on 31 Dec 2024)	(3,154)
Income taxes paid (1,810 in P&L + 174 payable balance on 1 Jan 2024 - 497 payable balance on 31 Dec 2024)	(1,487)
Other payments (cash contribution paid into pension scheme)	(120)
Net cash generated from operating activities	**9,449**
Cash Flows generated from Investing activities	
Cash proceeds from disposal of PPE (2,100 - 27)	2,073
Dividend income received in cash	1,260
Additional PPE purchased for cash (9,532 - 5,000 settled through an ordinary share issue)	(4,532)
Purchased financial asset in the year - for cash	(12,600)
Net cash generated from Investing activities	**(13,799)**

Cash Flows generated from Financing activities	
Ordinary dividends paid in the year	(3,500)
Issued debenture notes (25,000 - 18,000)	7,000
Net cash generated from Financing activities	**3,500**
Change in cash and cash equivalents in the period	**(850)**
Plus: Cash and cash equivalents from prior period	1,500
Cash and cash equivalents at end of the period	**650**

QUESTION THREE

Marking guide	Marks
a) Accounting policy adopted by Fresh Cuts Ltd for its costs *Accounting policy adopted for accounting for clean-up costs, Penalty costs and upgrading costs*	
Award marks as below:	
1 mark for a correct reference to the conceptual framework in a definition of an asset	1
1 mark for a justification of Fresh Cuts Ltd to present the penalty cost as an expense (rather than as an asset)	1
1 mark for an appropriate advice with a justification to account for the clean-up costs as an expense in the profit or loss rather than as a capitalized expense	1
1 mark for a correct reference to a capitalized expense that is presented as a PPE asset in accordance with IAS 16 PPE	1
1 mark for a justification of Fresh Cuts Ltd adopting an accounting policy (using IAS 8) to present the upgrade costs as capitalized under the PPE asset	1
Total marks for Q3 (a)	**5**
b) Accounting for the herd of cows and packaged meat for Fresh Cuts Ltd	
(i) Recognition and measurement of the herd of cows in accordance with IAS 41 *Agriculture*	
Award as below:	
1 mark for an appropriate definition of a "biological asset" in accordance with IAS 41	1
1 mark for a justification / reason that the herd of cows of Fresh Cuts Ltd qualify as biological assets in accordance with IAS 41	1
1 mark for a correct reference to an initial measure for the cows on 1 January 2024 (using the information provided in the scenario)	1

Marking guide	Marks
1 mark for a correct reference to the subsequent measure for the cows on 31 December 2024 (includes 0.5 mark for a correctly computed fair value increase on 31 December 2024)	1
2 marks for the allocation of the fair value change to the applicable components including the price change (1 mark) and the physical change (1 mark) - maximum of 2 marks	2
Total marks for Q3 (b)(i)	**6**
(ii) Accounting for the conversion of mature herd of cows (biological assets) into package meat for ordinary sales (inventory)	
Award as below:	
1 mark for a reference to the transition of the cows (biological asset under IAS 41) to packaged meat as inventory (under IAS 2) - and must apply the information in the scenario	1
1 mark for the initial measure of the packaged meat (including where applied 0.5 marks for the correct computation of the initial cost of the inventory)	1
1 mark for the adjustment in the measure for the packaged meat to a net realizable value amount (including 0.5 marks for a computation of the loss in value of the packaged meat as inventory)	1
Total marks for Q3 (b)(ii)	**3**
c) Accounting for the Financial Instruments for Fresh Cuts Ltd	
(i) The convertible loan notes issued by Fresh Cuts Ltd Award as below:	
1 mark for a correct reference from IAS 32 and IFRS 9 relating to the accounting treatment of a convertible loan note (as an example of a compound financial instrument) from the "issuer's perceptive" (**Do Not Award** where this is explained in the perceptive of a financial asset)	1
1 mark for a correct application of the convertible loan note issued by Fresh Cuts Ltd and indicating the requirement to separate the classification of the initial measure of the convertible loan note into a liability component and an equity component	1
0.5 mark for each correct figure / amount used in the computation of the initial measure of the liability component (includes 0.5 mark for compound present value of interest payment; 0.5 mark for discounted principal repayment and 0.5 mark for total amount of the liability component) - maximum of 1.5 marks	1.5
0.5 mark for the initial measure of the equity component (must indicate or compute this as a balancing figure)	0.5

Marking guide	Marks
1 mark for the correct computation of the liability component at the reporting date (31 December 2024) and 0.5 mark for the separate computation of or reference of the finance cost to be recognized in the profit or loss. Maximum of 1 mark	1.5
0.5 mark for indicating that carrying amount of the equity component at 31 December 2024 remain unchanged (same as the initial measure on 1 January 2024)	0.5
Total marks for Q3 (c)(i)	**6**
(ii) Classification of the issued irredeemable preference shares in the financial statements of Fresh Cuts Ltd	
Award as below:	
A reference to IAS 32 / IFRS 9, award 1 mark for a correct reference of a meaning / feature for a financial liability and 1 mark for a meaning of an equity instrument (maximum of 2 marks)	2
1 mark for each appropriate point used to evaluate the nature of the irredeemable preference shares issued by Fresh Cuts Ltd applied to IAS 32 / IFRS 9 - specifically as an (i) equity instrument (1 mark) and (ii) a financial liability (1 mark). A maximum of 2 marks	2
1 mark for an appropriate conclusion supported by the discussion (**Do Not Award** where the conclusion refers to the issued irredeemable preference shares as an equity instrument)	1
Total marks for Q3 (c)(ii)	**5**
Total Marks	**25**

Model Answer

Part (a): Accounting policy for the costs incurred by Fresh Cuts Ltd

In terms of the clean-up costs and penalty cost incurred by Fresh Cuts Ltd, there is no specific IFRS Accounting Standard that applies to the accounting for such expenses.

Therefore, in accordance with IAS 8 Accounting policies, changes in estimates and errors, Fresh Cuts Ltd is required to consider applying similar IFRS Accounting Standards and the Conceptual Framework in determining an appropriate accounting policy to account for the clean-up costs and the penalty cost.

Fresh Cuts Ltd should apply the Conceptual Framework is accounting for the incurred costs of clean-up and the penalty. The Conceptual Framework defines as asset as a right to an economic resource with the potential to produce economic benefits and is within the control of an entity as a result of past events. An asset should be recognized if this results in reliable and relevant information.

In view of Fresh Cuts Ltd, the clean-up costs and the penalty do not quality as assets in accordance with the conceptual framework and hence clean-up costs should have been expensed to the P&L rather than capitalization of these expenses.

In addition, Fresh Cuts will apply IAS 16 Property, plant and equipment in further assessing whether these upgrade costs can be capitalized. IAS 16 requires the capitalization of the asset if this results in probable future economic benefits and can be measured reliably.

The IAS 16 recognition criteria should be applied to determine whether the upgrade costs on the refrigerators are recognized as an asset. The upgrade of the refrigerators may result in probable future economic benefits flowing to Fresh Cuts Ltd (e.g., through increased revenue, reduced costs or increased efficiencies) in which case, it will be correct to recognize such costs as an asset. Otherwise these costs must be expensed off to the profit or loss.

The nature of the upgrade of the refrigerators aimed to reduce chemical leakages in the future suggests that if the upgrade of the assets, this will result in greater efficiency and therefore Fresh Cuts Ltd is correct to apply a capitalization policy to these costs.

Part (b): Accounting for the herd of cows and packaged meat for Fresh Cuts Ltd

(i) Explanation for the recognition and measurement of the herd of cows at 31 December 2024 for Fresh Cuts Ltd as biological assets in accordance with IAS 41 Agriculture

In accordance with IAS 41 Agriculture, a biological asset is a living animal or plant.

The purchased herd of 10,000 cows of Fresh Cuts Ltd qualify as biological assets in accordance with IAS 41 and will be recognized in the financial statements as the entity controls the cows, and it is probable that economic benefits through the sale of the packaged meat after their conversion will flow to the entity, the cost or fair value of the cows can be measured reliably.

On the day the herd of cows is purchased by Fresh Cuts Ltd (1 January 2024), they are initially measured at their fair value which is the purchase price of FRW 500 million incurred by Fresh Cuts Ltd on 1 January 2024.

Subsequently, at the reporting date (31 December 2024), the herd of cows as a biological asset (prior to conversion into packaged meat) are re-measured to a fair value less estimated point of sale costs which in the case of Fresh Cuts Ltd was FRW 750 million as the cows were now three-year cows.

By 31 December 2024, the two years' cow purchased on 1 January 2024 had then grown and they are three years old (2 years + one year). Consequently, Fresh Cuts Ltd will recognize a fair value gain of (750m – 500m) FRW 250m in profit or loss in accordance with IAS 41 with the following accounting entry:

Debit: Biological assets	FRW 250 million	
Credit: Profit or Loss (Fair value gain on biological assets)		FRW 250 million

In accordance with IAS 41, the fair value gain of FRW 250 million will comprise of:

- A price change component which represents the change in the fair value of two-year cows on 31 December 2024 compared to their fair value on 1 January 2024. In the case of Fresh Cuts Ltd, the fair value gain attributed to the price change is (600m – 500m) FRW 100 million.
- A physical change component which represents the difference in the fair value attributed to three-year cows compared to the fair value of two-year cows on 31 December 2024. In the case of Fresh Cuts Ltd, the fair value gain attributed to the physical change is (750m – 600m) FRW 150 million.

(ii) Accounting for the conversion of mature herd of cows into package meat for ordinary sales

In accordance with IAS 2 *Inventories*, an item of inventory is initially recognized as an asset and measured at cost which includes the purchase costs, conversion costs and any other costs required to get the inventory to its current condition and location.

In the case of Fresh Cuts Ltd, the conversion of the herd of 10,000 cows into packaged meat available for sale as part of the company's ordinary activity is evidence of a transition of the biological assets (under IAS 41) to inventories (IAS 2).

On the date of the conversion (31 December 2024), Fresh Cuts Ltd will de-recognize the biological assets from the financial statements at their fair value of FRW 750 million and recognize these as packaged meat inventory at the initial cost which will comprise of the fair value of FRW 760 million (750m plus conversion costs of FRW 10 million)

IAS 2 requires inventory to be carried at the lower of the cost and net realizable value at the reporting date with any loss in value recognized in the profit or loss. In the case of Fresh Cuts Ltd, the packaged meat as inventory at the reporting date (31 December 2024) at its net realizable value of FRW 720 million which is lower than the cost of FRW 760 million and therefore a fair value loss of (760m – 720m) FRW 40 million will be recognized in the profit or loss.

(c) Financial instruments of Fresh Cuts Ltd

(i) The convertible loan notes issued by Fresh Cuts Ltd

In accordance with IAS 32 Financial Instruments – Presentation and IFRS 9 Financial instruments, a compound financial instrument is a financial instrument that has both a liability and an equity component from the **issuer's perspective**.

In the case of Fresh Cuts Ltd, the issued convertible loan notes are an example of a compound financial instrument and therefore, the company will present both a liability and an equity component in the financial statements.

On the initial recognition of the issued convertible bonds on 1 January 2024, Fresh Cuts Ltd will have to allocate the total net proceeds received of FRW 20,000 to both the liability and equity components.

The liability component is measured by discounting the stream of future payments at the prevailing market rate for a similar liability without the associated equity component which is 9% as computed below:

Year	Cash Flows	Discount rate (9%)	Present Value (1 Jan 2024)
	Million		Million
Interest payments (6% x FRW 20,000m)	1,200	2.531	3,037
Principal refund	20,000	0,772	15,440
Liability component on 1 January 2024 (3,037 + 15,440)			**18,477**

The Equity component (on 1 January 2024) is computed as the balance amount (20,000 total proceeds of loan received less 18,477 liability component) FRW 1,523 million.

At the reporting date (31 December 2024), IFRS 9 requires the re-measurement of the liability component through amortization using the effective rate of interest while the equity component remains with the initial measure unchanged.

In the case of Fresh Cuts Ltd, the financial liability component is re-measured on 31 December 2024 to FRW 18,945 million which is computed as below:

Liability - 1 January 2024	18 477
Plus: Effective interest cost (9% x 18,477m)	1 663
Less: Cash interest paid (6% x 20,000m)	-1,200
Liability - 31 December 2024	**18 940**

A Finance cost based on the market effective rate of interest of 9% of (9% x 18,477m) FRW 1,663 million is recognized in the profit or loss and not just the cash paid interest of (6% x 20,000m) FRW 1,200 million.

The equity element at 31 December 2024 remains unchanged at its initial measure of FRW 1,523 million

(ii) Classification of the issued irredeemable preference shares in the financial statements of Fresh Cuts Ltd

In accordance with IAS 32 and IFRS 9, a financial liability exists where the entity has a contractual obligation to deliver cash while an equity instrument is the residual interest of the entity assets after deducting all liabilities

In the case of Fresh Cuts Ltd, the issued irredeemable preference shares by the company would qualify as an equity instrument in legal form since the company will have no contractual obligation to refund the principal amount of FRW 500 million to the preference shareholders in the foreseeable future

However, on the basis that Fresh Cuts Ltd has a contractual obligation to pay an annual dividend of (4% x 500m) FRW 20 million puts Fresh Cuts Ltd in a financial liability position (an obligation to the preference shareholders) whether or not the company has cash flows as these become a cumulative dividend.

For example, as these are a cumulative dividend, if Fresh Cuts Ltd is not able to settle the annual dividend due to cash flow difficulties, then Fresh Cuts Ltd is required to carry forward the unpaid dividends to a future date and get these settled when there are sufficient cash flows in preference to any other dividends to the ordinary shareholders.

Conclusion: Fresh Cuts Ltd must present the irredeemable preference share issued of FRW 500 million as a financial liability in its financial statements (under the non-current liabilities) while the annual cumulative dividends will be presented as a finance cost in the profit or loss.

QUESTION FOUR

Marking guide	Marks
a) Minimum components required in the published interim financial report of Paint Ltd	
Award 1 mark for each of the five components required to be published in the interim financial report for Paint Ltd. A maximum of 5 marks. These must apply to the case of Paint Ltd whose interim financial statements must cover the six-month period (January - June 2024) and will include the following: - A condensed statement of financial position (1 mark) - A condensed statement of comprehensive income (1 mark) - A condensed statement of changes in equity (1 mark) - A condensed statement of cash flows (1 mark)	
- A summary of the accounting policies and explanatory notes (1 mark)	5
b) Deferred tax implications related to the reported IFRS-based measure for the specialized machinery in the financial statements **Award as below:**	
1 mark for a correct reference to the meaning of a temporary difference in accordance with IAS 12 *Income Taxes*	1
1 mark for a correct meaning of a taxable temporary difference in accordance with IAS 12 (this also includes an example used to illustrate a taxable temporary difference in getting to explain the meaning.	1

Marking guide	Marks
0.5 mark for IAS 12's reference of applying a cumulative temporary difference as the basis of the deferred tax amount recognized in the statement of financial position; and 0.5 mark for IAS 12's reference that the change in the temporary difference is the basis of the amount of deferred tax reported in the profit or loss and OCI.	1
1 mark for IAS 12's reference to any situation where the change in the temporary difference is recognized in the OCI (rather than in the profit or loss)	1
1 mark for each correct application of the deferred tax accounting (recognition and measurement) related to the specialized machinery (PPE) of Paint Ltd (including 0.5 mark for each correct computation used in the explanation). This should include the deferred tax implication on 31 December 2023 and 31 December 2024 with a maximum of 5 marks	6
Do Not Award:	
An explanation for a meaning of a deductible temporary difference as this is applicable in the case of Paint Ltd	
Total marks for Q4 (b)	**10**
c) Defined Benefit Pension Plan for Plant Ltd	
Award 0.5 mark for each correct figure applied in the computation of the net pension asset carrying amount at the reporting date (31 December 2024). This should include:	
- Figures used in the presented extract of the Profit or loss (excluding any sub-totals and / or totals)	
- Figures used in the presented in the OCI (excluding any sub-totals and / or totals)	
- Figures used in the extract of the statement of financial position (**excluding** the provided balances on 1 January 2024 and 31 December 2024 and any sub-totals and / or totals)	
- Computation of the specific adjustment for the asset ceiling	
- Award 0.5 mark for each correct accounting journal as required (this will no mark if any part of the accounting journal is wrong). This mark is still awarded even where the figure used in the accounting journal is wrong as the mark is for the "recognition" not the "measurement"	
Maximum - 10 marks	**10**
Total Marks	**25**

Model Answer

(a) Minimum components required in the published interim financial report of Paint Ltd

In the preparation of the interim financial report for the six-monthly period (January – June 2024), paint Ltd, the following are minimum components as specified by IAS 34 Interim Financial Reporting:

- ✓ A condensed statement of financial position as at 30 June 2024 and a comparative statement of financial position as at 30 June 2023 (i.e., as of the end of the immediately preceding financial year)
- ✓ A condensed statement of comprehensive income (and income statement, if presented) for the current interim period for the six-monthly period ending 30 June 2024 and cumulatively for the current financial year to date, with comparative statements for the comparable interim periods (six-months to 30 June 2023 and the comparable year-to-date) of the immediately preceding financial year ended 31 December 2023.
- ✓ A condensed statement of changes in equity cumulatively for the current financial year to 30 June 2024, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year (i.e., at 30 June 2023)
- ✓ A condensed statement of cash flows cumulatively for the six-months in the current financial year to 30 June 2024, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year (i.e., at 30 June 2023)
- ✓ Selected explanatory notes to support the financial information and accounting policies applied in the preparation of the interim financial report of Paint Ltd for the six-month period ended 30 June 2024.

(b) Deferred tax implications related to the reported IFRS-based measure for the specialized machinery in the financial statements

In accordance with IAS 12 Income Taxes, a deferred tax arises where there is a temporary difference between the carrying amount of an asset or liability and its tax base. This is a temporary difference as it is expected to disappear in the future.

A temporary difference may be a taxable temporary difference that will result into a recognition of a deferred tax liability or a deductible temporary difference that results into a recognition of a deferred tax asset.

The deferred tax is computed using the cumulative temporary differences at the reporting date applied to an appropriate tax rate and recognized in the statement of financial position with any change in the deferred tax in the period recognized in the profit or loss and where applicable in the other comprehensive income.

In the case of the specialized machinery for Paint Ltd, the following deferred tax implications will be reported in the financial statements for:

Year-ended 31 December 2023

- A temporary difference will arise at 31 December 2023 for the machine in relation to the difference between the net carrying amount of FRW 1,000 million and the tax base of FRW 800 million amounting to (1,000m – 800m) FRW 200 million.
- This is a taxable temporary difference as the net carrying amount of FRW 1,000 million is higher than the tax base of FRW 800 million for the machine.
- Applying the tax rate of 30% for Plant Ltd, a deferred tax liability of (200m x 30%) FRW 60 million will be recognized in the financial statements for the year ended 31 December 2023.
- The accounting treatment on 31 December 2023 will be:
  Debit: Profit or Loss (Income tax expense) FRW 60 million
  Credit: Deferred tax liability (in the non-current liabilities) FRW 60 million

Year-ended 31 December 2024

- A cumulative taxable temporary difference will arise at 31 December 2024 for the machine in relation to the difference between the net carrying amount of FRW 1,250 million and the tax base of FRW 650 million. The cumulative taxable temporary difference will amount to (1,250m – 650m) FRW 600 million.
- Applying the tax rate of 30% for Plant Ltd, an adjusted carrying amount of the deferred tax liability of (600m x 30%) FRW 180 million will be recognized in the financial statements (within the non-current liabilities) for the year ended 31 December 2024.
- The additional deferred tax liability of (180m – 60m) FRW 120 million will be recognized in the financial statements for the year ended 31 December 2024 taking into consideration:
  - ✓ The deferred tax implication of the revaluation surplus on the machine of FRW 350 million amounting to (350m x 30% tax rate) FRW 105m recognized in the Other Comprehensive Income; and
  - ✓ The balance of the additional deferred tax liability in the year amounting to (120m – 105m) FRW 15 million recognized in the profit or loss (as part of the income tax expense)
- The accounting treatment on 31 December 2024 for the additional deferred tax liability in the year will be:
  Debit: Other Comprehensive Income (deferred tax) FRW 105 million
  Debit: Profit or Loss (Income tax expense) FRW 15 million
  Credit: Deferred tax liability (in the non-current liabilities) FRW 120 million

(c) Defined Benefit Pension Plan for Plant Ltd – year ended 31 December 2024

Extract in the Statement of profit or loss and OCI for the year ended 31 December 2024

P&L Section

Current service cost (W1) - *Debit*	190
Net interest income (in Finance cost) (W2) - *Credit*	1
Net Debit (190m - 1m)	**189**

OCI section

Net re-measurement gain (W5) - *Credit*	24
Reduction of net pension asset due to asset ceiling (W6) - *Debit*	7
Net Credit (24m- 7m)	**17**

Extract in the Statement of financial position as at 31 Dec 2024			
	Pension assets	**Pension obligations**	**Net Pension asset**
Opening balance - 1 Jan 2024 (as given)	720	700	20
Changes in the year to 31 Dec 2024:			
Current service cost (W1)		190	
Net interest income (W2)	29	28	1
Contributions PAID into pension scheme (W3)	200		
Benefits paid to retirees (W4)	(100)	(100)	0
Closing book values (before re-measurement differences)	**849**	**818**	**31**
Market values (at the year-end 31 Dec 2024) - Given	825	770	55
Re-measurement difference (Pension assets: 849m – 825m) (Pension obligation: 818m – 770m)	**24**	**48**	**24**
Compared with the NET ASSET CEILING amount (at 31 Dec 2024) as given			
Reduction of net pension asset due to asset ceiling (55m - 48m)			7

Accounting treatment (Workings) for specific items moving the Pension scheme in year ended 31 Dec 20X8

W1 Current service cost of FRW 190m

Debit: Profit or Loss (Current service cost)	190	
Credit: Pension obligations		190

W2 Net interest cost

Net interest income computed as:

Interest cost on pension obligations (interest rate 4% x Pension obligation at 1 Jan 2024 of FRW 700m)	28
Less:	
Interest income on pension assets (interest rate of 4% x Pension asset at 1 Jan 2024 of FRW 720m)	29
Net interest income (29m - 28m)	**1**

Accounting treatment for net interest income

Debit: Pension asset (with interest income)	29	
Credit: P&L (Finance cost)		1
Credit: Pension obligation (with interest expense)		28

W3 Contributions PAID into the pension scheme

Debit: Pension assets	200	
Credit: Cash and Bank		200

W4 Benefits paid to former employees / retirees

Debit: Pension obligations	100	
Credit: Pension assets		100

Note: In this case there is NO difference between the pension assets used to make the settlement and the pension obligations settled.

W5 Net re-measurement difference
Computed as:

Re-measurement difference (loss) on pension assets (849m - 825m)	24
Less:	
Re-measurement difference (gain) on pension obligations (818m - 770m)	48
Net re-measurement gain (48m - 24m)	**24**

Accounting treatment for net re-measurement gain

DR Net Pension asset (48m - 24m)	24	
CR OCI (net re-measurement gain)		24

W6 Impairment loss on Net pension asset - due to the asset ceiling
Computed as:

Net pension asset (book values)	55
Less: Recoverable amount (the asset ceiling)	48
Difference - write-down of net pension asset (55m less 48m)	**7**

Accounting treatment for effect of an asset ceiling

DR OCI	7	
CR Net Pension asset		7